

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 07-02**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Whether commodities futures contracts fall within the concept of "qualifying investment securities," as the term is defined by Tenn. Code Ann. § 67-4-2008(a)(12)(B)(iii).

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

The Taxpayer is a Delaware limited partnership organized pursuant to the provisions of the Delaware Revised Uniform Limited Partnership Act. The Taxpayer is a hedge fund that makes investments in a variety of financial products, including publicly-traded

securities, T-bills, futures contracts, swaps and other similar derivative contracts. A significant part of the Taxpayer's investment strategy involves trading in so-called commodity futures contracts.

A futures contract is an agreement to buy or sell a particular commodity (oil, gas, corn, soybeans and the like) or financial instrument at a given time in the future. Sometimes these contracts call for the physical delivery of assets, but most contracts expire before the commodity at issue actually changes hands. As a result, futures contracts are simply "paper transactions" in that they do not involve the purchase and sale of the actual products at issue but rather are contracts for the delivery of these products at a specified future date for a specified price.

Typically, these contracts are sold prior to the delivery date with the investor's profit or loss being measured by the difference between the price paid for the future contract and the price at which it is sold, multiplied by the contract size.

QUESTION PRESENTED

Are commodities futures contracts, as described above, properly included within the concept of "qualifying investment securities" under Tenn. Code Ann. § 67-4-2008(a)(12)(B)(iii)?

RULING

Yes.

ANALYSIS

Applicable Statutory Provisions

Tenn. Code Ann. § 67-4-2008(a)(12) exempts "diversified investing funds" from Tennessee excise taxation. Such funds are likewise exempt from Tennessee franchise taxation under Tenn. Code Ann. § 67-4-2105(a). Tenn. Code Ann. § 67-4-2008(a)(12) makes the following provisions:

- (a) There shall be exempt from the payment of the excise tax levied under this part the following:

- (12)(A) Diversified investing funds; provided, that, for purposes of this part, a diversified investing fund is a limited liability company, limited liability partnership, or limited partnership that meets all of the following requirements:

- (i) No less than ninety percent (90%) of the diversified investing fund's cost of its total assets consist of qualifying investment securities,

deposits at banks or other financial institutions and office space and equipment reasonably necessary to carry on its activities as a diversified investing fund;

- (ii) No less than ninety percent (90%) of its gross income consists of interest, dividends, and gains from the sale or exchange of qualifying investment securities; and
- (iii) Is formed and operated for the primary purpose of buying, holding, or selling qualifying investment securities, on its own behalf and not as a broker, and the capital of which fund is primarily derived from investments by entities or individuals who are not affiliated with the fund;

(B) For purposes of this subdivision (a)(12), the following provisions shall apply:

- (i) "Affiliated" means entities that are affiliates or part of an affiliated group;
- (ii) "Primary" and "primarily", over fifty percent (50%); and
- (iii) "Qualifying investment securities" include all of the following:
 - (a) Common stock, including preferred, or debt securities convertible into common stock, and preferred stock;
 - (b) Bonds, debentures, and other debt securities;
 - (c) Foreign and domestic currency deposits or equivalents and securities convertible into foreign securities;
 - (d) Mortgage or asset-backed securities secured by federal, state, or local governmental agencies;
 - (e) Repurchase agreements and loan participations;
 - (f) Foreign currency exchange contracts and forward and futures contracts on foreign currencies;
 - (g) Stock and bond index securities and futures contracts, and other similar financial securities and futures contracts on those securities;

- (h) Options for the purchase or sale of any of the securities, currencies, contracts, or financial instruments described in subdivisions (a)(12)(B)(iii)(a)-(a)(12)(B)(iii)(g), inclusive;
- (i) Warrants to purchase stock or an ownership interest in an entity;
- (j) An ownership interest in a limited liability company, limited liability partnership, or limited partnership; and
- (k) An ownership interest in a general partnership that would otherwise qualify as a diversified investing partnership under this subdivision (a)(12) were it not for its legal status as a general partnership[.]

*Commodities Futures Contracts Fall Within the Concept
Of "Qualifying Investment Securities"*

Tenn. Code Ann. § 67-4-2008(a)(12) sets forth a number of requirements that an entity must meet in order to qualify as a diversified investing fund. One of the requirements is that no less than 90% of the cost of the entity's total assets must consist of certain items, among which are "qualifying investment securities." The term "qualifying investment securities" is defined by Tenn. Code Ann. § 67-4-2008(a)(12)(B)(iii).

The sole question presented for this Letter Ruling is whether commodities futures contracts, as described in the facts above, are properly included within the concept of "qualifying investment securities" under Tenn. Code Ann. § 67-4-2008(a)(12)(B)(iii).

The statute contemplates that "qualifying investment securities" will include certain futures contracts. In fact, "futures contracts" on foreign currencies and on stock and bond index securities are specifically mentioned in Tenn. Code Ann. § 67-4-2008(a)(12)(B)(iii), subparagraphs (f) and (g).

In addition to "[s]tock and bond index securities and futures contracts", Tenn. Code Ann. § 67-4-2008(a)(12)(B)(iii)(g) also states that ". . . other similar financial securities and futures contracts on those securities" are also "qualifying investment securities" for purposes of the exemption provided by Tenn. Code Ann. § 67-4-2008(a)(12).

It does not appear that the above cited statutes can be construed so broadly as to include every conceivable type of futures contract, but it is entirely reasonable and in accordance with such statutes to classify futures contracts on assets such as commodities as "qualifying investment securities." Accordingly, the commodities futures contracts described in the facts presented above are among the "qualifying investment securities" contemplated by Tenn. Code Ann. § 67-4-2008(a)(12)(B)(iii)(g).

Arnold B. Clapp
Special Counsel to the Commissioner

APPROVED: Loren L. Chumley, Commissioner

DATE: 1-17-07